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JAPANESE INDUSTRIAL COLLUSION AND TRADE

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A STUDY

PREPARED FOR THE USE OF THE

SUBCOMMITTEE ON ECONOMIC GOALS AND INTERGOVERNMENTAL POLICY

OF THE

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LETTER OF TRANSMITTAL

JANUARY 24, 1986.

Hon. DAVID R. OBEY,
Chairman, Joint Economic Committee,
Congress of the United States, Washington, DC.

DEAR MR. CHAIRMAN: Enclosed is a study entitled "Japanese Industrial Collusion and Trade." It has been prepared by Mr. Jon Woronoff, an economics author who has spent many years in Tokyo.

The paper describes in detail the features which set the Japanese technique of stimulating economic development apart from our own. In particular, some of the data and material are presented for the popular American audience for the first time. The Japanese economy exhibits a unique blend of competition and collusion with dramatic implications for Japanese trade practices and patterns. In particular, it raises the issue for the first time whether Japanese firms and their exports meet antitrust standards prevailing elsewhere.

This study will enhance the debate in Congress regarding the proper balance of trade flows between Japan and the United States. It is an important addition to the trade debate. And I believe that subcommittee members, the Joint Economic Committee, and other Members of Congress will find it a valuable reference source.

The views expressed in this study are those of the author and do not necessarily represent the views of the committee members or the committee staff.

Sincerely,

LLOYD BENTSEN,
Vice Chairman, Subcommittee on Economic Goals and Intergovernmental Policy.

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CONTENTS

	Page
Letter of Transmittal	III

JAPANESE INDUSTRIAL COLLUSION AND TRADE

Historical Background	1
Multiple Combinations	3
Effects in Japan	6
Implications Abroad	9
The Consequences	12

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JAPANESE INDUSTRIAL COLLUSION AND TRADE

By Jon Woronoff

It is out of the question to understand how Japanese companies behave in Japan—or abroad—without some grasp of the antitrust situation. Yet, this aspect has rarely received careful or systematic attention although, now and then, it is realized that it is the missing link in the explanations we seek to certain phenomena.

Probably the most relevant point to raise, and this at the very outset, is that there is no hardy indigenous antitrust tradition of combating oligopolies, cartels, or other combinations. Nor is there much sign of public concern. Japanese society is characterized by special relations, connections, and cooperation in myriad forms and this, for many people, is simply regarded as just another.[1] More seriously, the Government has shown an exceptional tolerance of such combinations. Indeed, it was sometimes the Government that sponsored, encouraged or, indeed, imposed them.

Obviously, the emergence of what are generally regarded as restraints of trade has had far-reaching effects on every aspect of the domestic economy. It has conditioned the production system, the distribution networks, the manner in which products and parts are traded between companies, pricing and so on. In certain ways, it contributed to the imbalance between big and small companies and influenced the management system. In other ways, it created a strikingly different business philosophy as manifested by a strong concern for market share and a relative disconcern for profits.

Reaching yet further, it has repeatedly affected relations with other countries. It is a key to the difficulties foreign companies faced when they wanted to export goods to Japan or enter the market through joint ventures or their own operation. It has also pushed Japanese companies toward more active, frequently even aggressive, attempts to penetrate foreign markets. Finally, it helps explain why they have so often been successful at this.

Historical Background

It is hard to comprehend the present situation without knowing something about the past. From the most cursory study of how the Japanese economy arose and was shaped it immediately becomes clear that it was not rooted solely in free enterprise, no matter how highly it is praised. Shortly after being forced open by foreign intervention, the Government of the new Meiji state began constructing a strong industry which it regarded as vital for the nation's safety and independence. When some of its ventures failed, they were sold to private businessmen. Subsequently, the Govern-

[1] See Chie Nakane, *Japanese Society*, New York, Penguin Books, 1981.

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ment proceeded to support favored individuals and companies in crucial sectors.

Under this system, a small number of particularly dynamic groups were formed and gradually consolidated into *zaibatsu*.[2] They consisted of firms in a broad array of sectors which were brought under a holding company with much of the control in the hand's of the group's founding family. The largest of these were Mitsui, Mitsubishi, Sumitomo, and Yasuda. Such groups were especially active in modern fields like banking, trading, shipping, mining, and manufacturing. And they had links with smaller firms which often depended on them for work or finance. It is quite impossible to exaggerate the importance of the *zaibatsu* when one considers that the Big Four held 25 percent of Japan's industrial and financial capital.[3]

Since they were accused of collaborating with the military clique in launching the colonial and wartime adventures, the *zaibatsu* were slated for elimination by the Occupation authorities. SCAP ordered the liquidation of the holding companies and split some of the component firms in 1945.[4] But it did not break up the banks and, as of 1952, the sister companies began regrouping and some units actually assumed the same prewar name.[5] Now known as *keiretsu*, they were not as tightly organized as the *zaibatsu*, but they were uncommonly large and invasive.

Also under pressure from SCAP, an Antimonopoly Law was adopted in 1947. Initially, it was very strict, more so than the American laws on which it was modeled. Cartels were forbidden, overlapping shareholding was prohibited, mergers required prior approval, and monopoly power per se was illegal. But this legislation was promptly revised in 1949, and then again in 1953, in both cases to weaken it and permit the Government to reassert its influence while making it easier for companies to act as they wished.[6] Due to an abuse of power by certain companies at the time of the 1973 oil crisis, the Antimonopoly Law was tightened up again in 1977. But it was never made as strong as before.

This legislation was supervised and action taken to ensure its enforcement by a Fair Trade Commmission. The FTC has been reasonably busy and, on occasion, took legal action against companies that violated the law. However, more often, it applied administrative measures like recommendations or consent decrees.[7] It also proposed that the effort be spread to more sectors and argued in favor of free enterprise and an end to unfair business practices in general. Still, it had much less clout than the other bureaucracies it had to contend with. Worse, it was not truly independent in one sense. Its Chairman was appointed by the Ministry of Finance and,

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[2] See William W. Lockwood, *The Economic Development of Japan*, Princeton, Princeton University Press, 1954.

[3] Lockwood, "Japan's New Capitalism," in William Lockwood (ed.), *The State and Economic Enterprise in Japan*, Princeton, Princeton University Press, 1965, p. 495.

[4] See T.A. Bisson, *Zaibatsu Dissolution in Japan*, Berkeley, University of California Press, 1954.

[5] See Lockwood, *op. cit.*, pp. 495–497.

[6] See Eleanor Hadley, *Antitrust in Japan*, Princeton, Princeton University Press, 1970, and Hiroshi Iyori, *Antimonopoly Legislation in Japan*, New York, Federal Legal Publications, 1969.

[7] *Japan Economic Journal*, June 15, 1982.

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even at present, some of its relatively small staff is seconded from other bureaucracies.

This would not be so serious if the Ministry of Finance and especially the Ministry of International Trade and Industry were not staunchly interventionist. They resumed the old tradition of government direction and guidance of the economy which goes back to Meiji days and also, yet more directly, the controlled wartime economy. During the postwar years, MITI managed to enhance its power and obtained, through the 1953 revision, the possibility of establishing "rationalization" and "recession" cartels.[8] It also championed mergers of smaller companies to create powerful Japanese entities. MOF, lest it be forgotten, also regulated its sector rather firmly, exercising close supervision over the banks, insurance companies, securities houses, and so on.

Meanwhile, the business community was also regrouping and reasserting its old position. It gained considerable sway over the ruling Liberal Democratic Party due to huge contributions to political campaigns. It exerted great influence over the bureaucracy as well since it hired retired officials. The 1947 revision of the Antimonopoly Law allowed it to reconstitute trade associations which brought together all members of the industry, competitors in normal circumstances who cooperated in joint activities and engaged in some market regulation. This was all topped by the prestigious Japan Federation of Economic Organizations (Keidanren).[9]

Perhaps more significant than the visible actions of the business community was the general attitude. Japanese managers had worked under close government supervision and engaged in considerable cooperation (and collusion) before and during the war. There was a brief interlude of relative laissez-faire under the Occupation and until the SCAP laws could be revised. As even an FTC member had to admit, "businessmen with a long tradition of cartels and trade associations can understand regulations arrived at after discussion among the competitors much more readily than they can the bizarre notion that concerted action constitutes an unreasonable restraint of trade." [10] They therefore regretted and criticized the anitrust legislation and did their best to weaken or evade it. The Fair Trade Commission, which was a gadfly more than a watchdog, could not always prevent this.

Multiple Combinations

Since Japanese companies and managers have a different background and work under differnt circumstances, it is not surprising to find that they do not always behave in the same manner as their American or European counterparts. Some of their practices would clearly run afoul of the antitrust legislation in the United States and are rather dubious if not always strictly illegal, under the Japanese dispensation. Nothing is more symbolic of this than

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[8] See Chalmers Johnson, *MITI and the Japanese Miracle*, Stanford, Stanford University Press, 1982.

[9] See Dan Fenno Henderson, *Foreign Enterprise in Japan*, Tokyo, Tuttle, 1973, pp. 128–154.

[10] Quoted in Henderson, *op. cit.*, p. 145.

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the extraordinary proliferation of groupings of various sorts, often referred to innocuously as "alignments" (*keiretsu*).

Most noticeable are the banking "alignments" or *kin'yu keiretsu*.[11] Three of them are lineal descendants of the prewar *zaibatsu*, tracing their origin back to the Houses of Mitsubishi, Mitsui, and Sumitomo. Others only came together after the war, assembling earlier groups that had disbanded and other companies that sought the advantages of such links. The more successful of them are the Fuyo (Fuji) Group, Dai-Ichi Kangyo Group, and the Sanwa Group, with the Tokai and Industrial Bank of Japan Groups still somewhat smaller and weaker.

These are very broad groups which cover a multitude of sectors from services to manufacturing. The "core" unit initially was the bank whose aid was crucial in obtaining financing just after the war. It was soon joined by the general trading company (*sogo shosha*) which possessed numerous contacts with other member companies as well as its own clientele. In some groups, a manufacturing company is also prominent, such as Mitsubishi Heavy Industries or Sumitomo Metal.

The links between these groups take various forms. One is crossholding of stock, with the crossholding ratio varying from 14–23 percent. Members appoint directors to one another's boards and exchange personnel at lower levels. They also attend councils of presidents and launch joint projects. The scope of such groups is truly impressive. The larger ones have anywhere from 80 to 140 members, each with its own subsidiaries and affiliates. Mitsubishi, the biggest, has sales in excess of 35 trillion yen and as many as 360,000 employees.

A second category is the "enterprise" (*kigyo*) *keiretsu*. These are vertical groupings which arise primarily in industrial sectors where extensive subcontracting takes place. Dominant assemblers either create new subsidiaries or absorb existing companies. These lesser firms provide the necessary parts and components or render certain essential services. The major such groups are those of Nippon Steel, Hitachi, Nissan, Toyota, Matsushita, Toshiba, Tokyu, and Seibu. But there are dozens more and this is a standard pattern in sectors such as automobiles, motorcycles, shipbuilding, electronics, sewing machines, and so on.[12]

This time the relations are much closer. The parent company usually holds considerable stock in its "family" of suppliers, often more than a majority. Where it does not, the subordinate firm may be bound by personnel, sales, or other connections. In these groups, it is not unusual for the larger company to appoint more than just directors and even to transfer its managers there. These *keiretsu* are also quite large, with sales ranging from 2–10 trillion yen and a work force as high as 200,000. Toyota, for example, has 220 primary suppliers and over 1,000 secondary and tertiary ones, while Matsushita has over 500 subsidiaries and affiliates.[13]

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[11] Dodwell Marketing Consultants, *Industrial Groupings in Japan*, Tokyo, 1984, pp. 50–113.
[12] Dodwell, *op. cit.*, pp. 114–150.
[13] See Dodwell, *Key Players in the Japanese Electronics Industry*, Tokyo, 1985, and *The Structure of the Japanese Auto Parts Industry*, Tokyo, 1983.

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A third category consists of the distribution *keiretsu* (*ryutsu keiretsuka*), also known as "distribution channelization" and "integrated marketing networks."[14] In some cases, manufacturers established control over the wholesalers and retail outlets. Another variation is for wholesalers to control their network of retailers. The links frequently involve direct financial participation and appointment of board members. Where the links are weaker, they take the form of sales aids, advancing credit, or use of rebates. In return, the manufacturer will impose certain conditions, many of which are regarded as anticompetitive by the FTC. They include customer, territorial, and dealing restrictions as well as resale price maintenance.[15]

Finally, there are cartels in which independent and completely unrelated companies agree on certain forms of cooperation or market manipulation. Some of these cartels are "legal" and even enforced by "administrative guidance" from the Government, most often from MITI.[16] There are a fair number of such cartels, most of them only created for a limited period of time but periodically extended. Other cartels are "illegal" in the sense that they were formed by the companies concerned without authorization from the Government.[17]

The issue of legality is rather intriguing since both types of cartels might apply similar measures and, indeed, the Government-sponsored ones usually go much further in controlling output and thereby price. In addition, the whole basis of their legality is questionable since "administrative guidance" itself, under which they are created, is not strictly legal although it is certainly tolerated.[18]

So, although the *zaibatsu* are gone, the *keiretsu* and others are here. It must be admitted that the links are no longer as close or the power as overwhelming. Still, the groupings have done very nicely for themselves and their position can hardly be ignored. The 16 major groups alone, the top 8 bank and top 8 enterprise "alignments," have some 1,000 member companies. That is a mere 0.6 percent of the total number of companies in Japan. Yet, they possess 10 percent of all employees, 24 percent of all annual sales and 26 percent of all paid-up capital.[19] While not as much as the old *zaibatsu*, it is quite impressive. In addition, they are growing faster than other companies and thus their advantage is being continually reinforced.

Moreover, in considering these various groupings, it must be remembered that they are not mutually exclusive. It is entirely possible for a given company to be involved in two, three, or even four categories. It could be a member of a bank "alignment," have its own "family" of subcontractors, control its own distribution net-

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[14] See Hideto Ishida, "Anticompetitive Practices in the Distribution of Goods and Services in Japan: The Problem of Distribution Keiretsu," *Journal of Japanese Studies*, vol. 9, No. 2, summer 1983, pp. 319–334.

[15] See J. Amanda Covey, "Vertical Restraints Under Japanese Law: The Antimonopoly Law Study Group Report," *Law in Japan*, vol. 14, 1981, pp. 49–81.

[16] Among the sectors covered by MITI's action are major ones such as aluminum, chemical fibers, fertilizers, ferroalloys, paper and cardboard, and petrochemicals.

[17] Some of the "illegal" cartels which were actually uncovered include those for cement, soda ash, monosodium glutamate, and oil.

[18] See Johnson, *op. cit.*, 242–274.

[19] Dodwell, *Industrial Groupings in Japan*, pp. 40–43.

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work and also partake in an approved (or illegal) cartel. In fact, it is the multifarious connections between these four types, each of which is already quite an infringement on free enterprise, that makes the system so influential and irradicable.

Effects in Japan

This web of companies, linked with one another in various combinations, naturally had a pervasive impact on how the economic system functioned. In some ways, their effect was so strong as to distort the market forces and stifle the normal play of supply and demand. Price was no longer the sole, or primary, or sometimes even a substantial determinant of how deals were concluded. Companies that belonged to the same groups did business together routinely. Even if fellow members offered somewhat worse quality, delivery or price conditions, they would tend not to foresake them because they wanted the same preferential treatment in return.

This in turn led to considerable stability amongst the companies on the market. Since there were only half-a-dozen major groups, each with one member from a given sector, there tended not to be many more companies active in any sector. Or, if there were, they tended on the whole to be smaller and less viable. The market shares that each attained did not usually change very rapidly or radically. While there were occasionally new companies which broke in, the more frequent occurrence was for older ones to be squeezed out.

This in itself contributed to the rise of large companies and appreciable degrees of concentration in each sector. But there were a number of other aspects of the Japanese economic system that further encouraged this. One was the traditional respect for size as a main attribute of status, as opposed to wealth. This doubtlessly influenced one of the biggest deviations from what is commonly regarded as capitalist practice everywhere; namely, the drive for profit, which was clearly less of a concern in Japan than an increse in market share. Another crucial element was the urge for economies of scale, seen as a way of keeping costs low but also of attaining greater sales and consequently more market share.

The kind of competition that arose in Japan was, therefore, rather different from what was experienced abroad. First of all, it was not based so much on intrinsic differences between products, with each company or group trying to develop something unique. Rather, due to the "one-set" principle, most *keiretsu* included every major kind of company and thereby every major line of business in their general panoply. They all had banks, insurance companies, trading companies, shipyards, steelmills, and so on so that a member could find much of what it needed internally. Individual companies also tended to develop an extensive range of articles, each with much the same lineup as its rivals. When a new product came out, within a short time they all had the same. This was most noticable among the electronics makers.

The competition was also not based very much on quality since most Japanese makers had about the same level of technical competence and strove for the same attentiveness in their labor force. The ability to meet deadlines, to provide just-in-time delivery and

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to package and present the product were also similar. Even cost price was usually not much of a distinguishing factor since all paid as much for inputs, had similar machinery, recruited workers who earned pretty much the same wages and had comparable distribution costs.

There were only a few points where they might gain an advantage and these were often tied up closely with the phenomena of groupings. Membership in a larger *keiretsu* gave them access to a larger potential clientele. Links to a larger bank, or to more banks, gave them more and cheaper funds to draw on when they needed it. Creation of a "family" of suppliers provided them with parts and components whose costs could be depressed by leaning on their subsidiaries and subcontractors. Last, but most definitely not least, the larger the network for sales outlets, the more wholesalers and retailers they controlled, the broader access they had to the consumers.

Thus, competition often took the form of creating more subsidiaries, establishing closer links with other companies and especially strengthening their marketing apparatus. Meanwhile, the sales price of goods remained relatively stable. With similar costs, and similar profit aspirations, companies did not usually have much of an edge over one another and they did not ordinarily try to boost sales by lowering their prices and risking their margins. They could keep the prices all the more stable in that most makers imposed fixed prices on their distributors, carefully monitored the maintenance of these prices and penalized distributors who tried to break the front. In so doing, they were engaging in what the FTC regarded as violation of antitrust.[20] But it has not been very successful in eliminating it.

Contrary to what the Japanese claim, their economy was not really characterized by fierce competition but rather by a tacit and sometimes active collusion. The relative stability was only disrupted on occasion, and then usually only for one product or another as opposed to competition all along the line. This breach, however, could be more alarming in the relative stability and did take on some particularly virulent forms for reasons that are also inherent in the Japanese system. It was only then that one encountered what is referred to locally, with some dread, as "excessive competition" (*kato kyoso*).[21]

The excesses derive from two of the characteristics already mentioned. The first is the urge for market share. This stimulates a completely different kind of competition from a mere urge for profit. It is possible for several companies to strive for higher profits and all succeed to differing degrees with relatively little market disturbance. There is no absolute limit to how much profit can be earned. But there is an impenetrable ceiling to how much market share can be attained. There is only 100 percent and every time one company increases its share, other companies must lose. Taken further, if one or more companies increase their market share no-

[20] Covey, *op. cit.* pp. 63-64.
[21] See Jon Woronoff, *The Japan Syndrome*. New Brunswick, Transaction Books, 1985, pp. 53-57.

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tably, the rest could be driven out entirely. This makes the stakes much higher.

The other element is economies of scale. In order to compete on price, companies which are so similar have to achieve the lowest production costs and this is usually sought by larger scale. Most Japanese companies are thus as addicted to scale as they are to market share and they rarely consider the drawbacks. Moreover, they seem to be rather poor at forecasting future demand since they often expand capacity well beyond the existing or foreseeable ability of sales to keep up. This often saddles them with incredibly large capacity, excess capacity unless they can somehow find a use for it.

There are numerous examples of this. The Japanese steel industry boosted capacity to 150 million tons but is still only using about 100 million tons thereof. Shipyards were built large enough to more than supply the world demand for ships and over the past decade not even a fifth has been needed. More recently, facilities for 64K RAM chips expanded so far that there was soon massive oversupply. Not having learned from that, the capacity of 256K RAM chips was also built up too high. And the like can be expected for 1-megabit RAM chips in the future. At present, the Japanese capacity for VTR's or machine tools is larger than the total world demand. And they are doing the same for high grade ceramics and carbon fiber.

With excess capacity, it was obviously necessary to fight very hard to sell as much as possible. Otherwise the economies of scale did not contribute to profits but rather incited losses. Worse, the managers responsible for foolish investments might be in trouble. With relatively high fixed costs in the form of machinery and lifetime employment burdening them with fixed personnel costs, companies were forced to sell at nearly any price. This was seen lately in the three-cornered race for motorcycle sales or the scramble to sell chips. So, periodically, the price for specific goods just collapsed in an orgy of competition. The winners were usually those which ran a tighter organization or, more likely, could draw more heavily from a group bank.

Sometimes, the competition was further exacerbated by a number of practices which display much less economic rationality. One was the attempt by leading companies in the sector, or powerful outsiders that wanted to break in, to use their financial and marketing strength to drive out weaker players. They would expand capacity even if it was redundant because they assumed their domestic (and foreign) rivals would cave in first. The other was the decision by the Japanese Government, mainly in the form of MITI, to promote a given industry that had been targeted and thus benefited from cheap loans, protected markets, R&D grants, subsidies, and other support.[22] This meant they could expand, and overexpand, at the cost of the nation.

The result of all this was a reinforcement of some few companies in each sector which managed to grab a hefty chunk of the market. Over the years, the number of sectors dominated by one, two, or

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[22] Ira C. Magaziner and Thomas M. Hout, *Japanese Industrial Policy*, London, Policy Studies Institute, 1980, and Ezra Vogel, *Comeback*, New York, Simon and Schuster, 1985, pp. 27-167.

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three companies has not ceased rising and often their combined market share has risen as well. This trend can be expected to intensify with slower economic growth since there are fewer chances for weaker firms to hold on. This makes oligopolies, and even monopolies, a prominent feature of the economic landscape. Some examples in products for which Japan is noted (and the combined share of the top three products) are passenger cars (72 percent), motorcycles (94 percent), video tape recorders (58 percent), photocopiers (86 percent), watches (91 percent), and calculators (93 percent).

Of course, with a relatively small number of companies dominating the market, it was easier to restore stability after a bout of *kato kyoso*. They eventually realized that even more strenuous efforts would not change the market share situation very much. They felt that what they could gain was less than what they were likely to lose. They then reached an understanding and the prices ceased falling. Indeed, they often began rising again. It was exceedingly difficult to prove collusion in such cases. But there was ample cause for suspicion.

Implications Abroad

If the consequences of close relations, heavy concentration and occasional collusion and other manifestations of a loose antitrust situation were limited to Japan, there would not be much justification for concern abroad. However, it is quite impossible for such distortions not to affect other companies and other countries, especially in an increasingly integrated world economy. The effects certainly could be felt and their harmful nature is increasingly evident.

One side of the problem arose for foreign companies which tried to export to Japan. They repeatedly encountered trade barriers, only some of which have been properly identified.[23] The most visible are tariffs and quotas, most of which have been or are being reduced to acceptable levels. Then come the nontariff barriers, many of which are also being dealt with. But behind this lie the most tenacious of all, those rooted in the distribution system.[24] They are often intimately related to the various forms of combination cited.

First of all, the existence of *keiretsu* strongly encouraged member companies to do business with one another. The very comprehensive nature of these groups, which have systematically included members in just about every major sector, only makes things worse. For most essential services and many leading products there was a supplier that enjoyed a definite preference, although it was not absolute.

There is no shortage of examples as to how this works. The group bank or insurance company would have priority over any outside institution and the trading company would go further by putting its goods on the group shipping line and urging its clients to use a member insurance company. There are also regular sales

[23] See Jon Woronoff, *World Trade War*. New York, Praeger, 1984, pp. 55–107.
[24] See Michael R. Czinkota and Jon Woronoff, *Japan's Distribution Barriers*. New York, Praeger, 1986.

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of products from one member to another, the steel company, for example, being a prime supplier of the shipbuilder and automaker. The trading company would have first crack both at importing new materials for manufacturers and selling their finished products abroad.

Nowadays, a large portion of trade is not in finished products but rather parts and components. Here, the preference which parent companies gave their subsidiaries, affiliates and subcontractors was considerably more substantial. They established these companies specifically as suppliers and worked closely with them. When they held stock in these companies, they thought more than twice before importing foreign parts and components. Even if offered at a lower price, they might not accept the deal.

The distribution *keiretsu* tied up the market even tighter as regards most consumer goods. Where manufacturers controlled the wholesalers or retail outlets, they could determine which articles were sold and easily veto the sale of imported products that competed with their own. Indeed, in many of the distribution networks the rule was exclusive dealers and, even in some supposedly independent outlets, the owner would be wary of upsetting his customary supplier. Where wholesalers dominated the retailers, and either belonged to or themselves owned manufacturers, they would refuse to serve as channels for competing imports or, at most give them second-best treatment.

Similar problems existed with the cartels. In fact, the "legal" ones were probably more discriminatory because an essential element of MITI's rationalization policy has been to restrict imports so as to preserve the ailing companies whose capacity they are reducing. The "illegal" cartels were usually formed in order to boost prices and profits. But, if this manipulation were threatened by cheaper imports, they would also do their best to impede them. That could be accomplished through pressure on the relevant importers, whether *sogo shosha* or smaller traders and wholesalers, with whom they have considerable leverage.

When one considers the many forms such collusion took, it is not at all surprising that it was hard for foreign products to penetrate the Japanese market. Here, it must be stressed that the products and services that were blocked were not necessarily inferior. They might display admirable quality, be delivered very promptly and cost less than Japanese counterparts. They were excluded for entirely different reasons; namely, control of the market. If they never reached the potential purchasers or consumers it did not really matter how good they were.

Incidentally, this also explained the rather limited and intricate ways in which more fortunate foreign companies ultimately did get in. It has long been stressed that foreign goods should be "unique" if they want to succeed in Japan. This sort of demand is raised nowhere else in the world. Uniqueness is crucial here because only such products or services had no local counterparts and were therefore not protected. Moreover, to sell, foreigners were regularly advised to pass through a Japanese importer or wholesaler. That was essential because they controlled the existing distribution outlets and it was extremely difficult either to get around them or create one's own.

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When it comes to Japanese exporting abroad, this system had equally noteworthy effects. The most obvious was that weaker firms had no choice but to export or go under. Latecomers which did not have their own distribution network, or were unable to borrow one, could not even sell at home. They had no alternative but to sell abroad. Only the external markets permitted them to generate revenue, expand scale, and remain viable. This is the predicament which many Japanese companies faced although their products were certainly as good, cheap, reliable, and so on. The result was avid exporters, some of whom were heavily dependent on foreign markets to get by. Here mention need merely be made of Honda and Sony.

Knowing that substantial sales abroad would permit rivals they had already beaten domestically to survive and then gradually boost production, the more established companies were pushed in the same direction. They already had the typical, almost reflex-action urge to export. But they were driven harder by the need to keep their rivals from getting a solid enough foreign base to come back and challenge them in Japan. Thus, national rivalries continually spilled over into international markets.

When this happened, the Japanese intruders were hard to beat because they encountered foreign companies which operated on a completely different basis. In America, for example, managers had to earn a profit and they were not willing to engage in as tough price competition as the Japanese who were willing to sacrifice profit until they got a desired market share. This attitude led the Japanese to sell at a very low profit, and sometimes no profit at all, on the assumption that it could be recouped later. The result was predatory pricing, at least in the eyes of the local rivals, and sometimes outright dumping.[25]

While American companies may be criticized for not reacting in kind, at least to safeguard their own market share, it must be remembered that, first of all, this did not appear as rational behavior to them. Second, they were under greater pressure from their shareholders to make some profit and pay decent dividends. But, and this third point is the most significant, even if they wished to fight back they were not able to do so as ruthlessly as the Japanese.

The reason is quite simple. As was already pointed out, the Japanese companies had created a safe haven for themselves in the domestic market. Once things had been worked out and the existing market shares were more or less acceptable, they did not engage in much price competition. As a matter of fact, it was not very difficult for them to boost their prices at home in order to charge lower prices abroad. They could thereby make bigger profits at home to cover any losses abroad. In this way domestic sales subsidized foreign sales and the Japanese managers could sustain their price-cutting activities long after American managers had to give in.

American companies, which faced competition both at home and abroad, could not possibly play the same game. They had no choice

[25] There have been numerous cases of dumping and even more allegations thereof, which at least indicates predatory pricing, for television, chips, computers, machine tools, ball bearings, and so on.

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but to accept some erosion in market share in order to maintain profits. Indeed, when the onslaught came, they were lucky just to avoid losses and some, which were less fortunate, eventually went under. It was only when enough local competitors had disappeared and the Japanese held as much market share as they thought they could handle (for the moment, at least), that the competition ceased. They then proceeded to align their own prices on the prevailing level and to make the profits they needed to cover any earlier losses or launch another competitive attack on yet another market.

So far, these tactics have been remarkably successful. Japanese companies have been able to penetrate one market after another for one product after another.[24] Once getting a foothold, they have been able to push back their local rivals and increase their market share. They have not always been able to recoup their losses yet, but they hope to do so in the future. Certainly, when they hold a big market share and sometimes even obtain a quasi-monopoly, it should not be difficult.

Just in case this may sound a bit farfetched, it might be mentioned that the Japanese have already become the predominent suppliers of a long and growing list of goods for which they tend to be the market leaders . . . or more. Japan already has a dominant share of the market for ships, motorcycles, machine tools and robots, color televisions, video tape recorders, and other consumer electronics. There are relatively few remaining competitors for steel, ball bearings, cameras, and watches. And there are even individual companies which are winning a world monopoly for specific items, such as YKK for industrial fasteners and zippers.

The Consequences

It is generally felt that combinations and collusion among companies must have very noticable negative effects on the domestic economy. Indeed, the consequences should be so deplorable as to arouse popular resentment and incite efforts to do away with, or at least restrain, them. Do these conclusions apply to Japan? Or it is somehow an exception?

It is clear that there has been a tremendous amount of concentration, with a few leading companies having appreciable shares of the domestic market. It is equally clear that these companies managed to hold on to their market share in manners that were not regarded as entirely fair by others; namely, through stringent barriers to entry or impediments to selling. On occasion, their intense competition drove existing companies out of business with resulting job losses. The worse, if less visible impact, however, was to stifle the birth of new companies which could launch new products and take on more workers.

These various combinations also narrowed the consumer's range of choice. Due to a small number of companies in each sector, most of them making similar products or—after agreement—variants which they tended to monopolize, there has obviously been a defi-

[24] See Jack Baranson, *The Japanese Challenge to U.S. Industry*, Lexington, D.C. Heath, 1981, and Daniel I. Okimoto et al., *Competitive Edge, the Semiconductor Industry in the U.S. and Japan*, Stanford, Stanford University Press, 1984.

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nite limitation. This is not seen so much in the actual number of articles, which is quite large, but in the lack of somewhat different and often either cheaper or more sophisticated imported products. The selection of passenger cars available to the average consumer is smaller, for example, and foreign electronics, textiles and garments, watches, and so on are even harder to find.

Moreover, these combinations have led to higher prices for whatever goods are available. Most obvious are the assorted imported products whose prices are kept artificially high to promote a "luxury image" (and also to keep sales low). But the same sort of thing happens for products that are made-in-Japan. Since they do not face cheaper imports, and since price competition is limited, the prices are set by the makers at levels they deem appropriate. There are amazingly few sectors in which distributors have broken out of the fixed price system and offer sales or discounts.

From the action of the Fair Trade Commission, it is evident that the prices are not always determined by supply and demand. There is a strong tendency toward "parallel price increases," which is one of the FTC's main concerns. There is even cruder price fixing among makers on occasion. This has occurred in dozens of sectors, including major ones like pharmaceuticals, steel, paper, alcoholic beverages, and oil.[27]

Yet, there has not been much of an outcry. The FTC has threatened and cajoled. It levied some fines and even prosecuted some companies. The public has sporadically shown annoyance, especially in the case of color television and cosmetics. But, by and large, prices are accepted as given and no vigorous consumers' movement has emerged to date. In the absence of serious pressure from the electorate, the ruling party has naturally paid more attention to the more clearly expressed views of the bureaucracy and business community which praise the advantages of cooperation and brush over the corresponding dangers.

This lapse can probably be explained by the fact that the worst consequences have not been felt by the Japanese due to the buffer of external markets. Companies which would normally have gone to the wall manage to survive by producing for export. Indeed, some of them have become just vestigially Japanese with well over half, and sometimes as much as 90 percent, of their business abroad. This has avoided numerous bankruptcies and the consequent loss of jobs. In addition, by producing for a world market, it is possible to produce at sufficiently large scales that prices, although higher than otherwise due to collusion, are not so high as to cause unrest.

If the Japanese market did not have such a safety valve, the pressure might have become unbearable. It is obvious that much of the growth of the past decades would never have occurred if Japanese companies were limited to the Japanese market. It is equally obvious that there would have been considerably more bankruptcies and job losses if they were limited to domestic sales. And prices would be far higher than today, too high to be afforded by Japanese whose own earnings would not be as good. Indeed, the

[27] See Fair Trade Commission. *Annual Reports.*

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system might not have worked if the Japanese were able to export but also, in return for this, had to import foreign goods normally.

The worst damage therefore arose not in Japan but in its trading partners. It was the foreign markets which were invaded, whose companies went bankrupt and whose workers lost jobs. That the American, European, and other governments and publics tolerated the banaful consequences of Japanese practices is considerably more inexplicable than that the attenuated costs (and related benefits) were accepted in Japan.

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